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No. 97-2045

FILED
NOV 10 1998
OFFICE OF THE CLERK
SUPREME COURT, U.S.

In The

Supreme Court of the United States

October Term, 1998

SOUTH CENTRAL BELL TELEPHONE COMPANY, *et al.*,

Petitioners,

vs.

STATE OF ALABAMA AND
STATE DEPARTMENT OF REVENUE,

Respondents.

On Writ of Certiorari to the Supreme Court of Alabama

BRIEF OF *AMICI CURIAE* AVON PRODUCTS, INC., BURGER KING CORPORATION, CYTEC INDUSTRIES INC., DARDEN RESTAURANTS, GEORGIA-PACIFIC CORPORATION, HEALTHSOUTH CORPORATION, INSILCO CORPORATION, MATSUSHITA ELECTRIC CORPORATION OF AMERICA, THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, R.J. REYNOLDS TOBACCO COMPANY, AND TRICON GLOBAL RESTAURANTS, INC. IN SUPPORT OF PETITIONERS

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1998

QUESTIONS PRESENTED

1. Whether the Alabama Supreme Court, following the same practice that this Court condemned in *Richards v. Jefferson County*, 517 U.S. 793 (1996), deprived petitioners of the due process of law guaranteed by the Fourteenth Amendment by barring them from presenting a federal constitutional challenge to a state tax on the theory that petitioners were bound by a prior state-court judgment in a case to which they were not parties, in which they were not represented, and of which they had no notice.

2. Whether Alabama's franchise tax impermissibly discriminates against interstate commerce, in violation of the Commerce Clause, by taxing Alabama corporations only on the par or stated value of their stock (the amount of which is determined solely by the corporation itself) while taxing out-of-state corporations on the value of essentially all their capital employed in Alabama, with the demonstrated result that Alabama corporations on average pay less than one-fifth of the franchise tax they would pay if they were incorporated outside Alabama.

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CONSENT OF THE PARTIES

Written consents of petitioners and respondents have been obtained and filed with the Clerk of the Court.[1]

INTEREST OF *AMICI CURIAE*

Pursuant to S. Ct. R. 37, Avon Products, Inc., Burger King Corporation, Cytec Industries Inc., Darden Restaurants, Georgia-Pacific Corporation, HealthSouth Corporation, Insilco Corporation, Matsushita Electric Corporation of America, Inc., The Prudential Insurance Company of America, R.J. Reynolds Tobacco Company, and Tricon Global Restaurants, Inc. ("*amici*") respectfully submit this brief as *amici curiae* in support of petitioners in the above-captioned case.

Amici, corporations organized under laws of States other than Alabama (referred to herein as "foreign corporations"), are engaged in interstate commerce, including doing business in Alabama. Consequently, *amici* are subject to the discriminatory Alabama franchise tax on foreign corporations. Ala. Code § 40-14-41 (1993). This case is important to *amici* because Alabama continues to collect this tax from *amici* in reliance on *White v. Reynolds Metals Co.*, 558 So. 2d 373 (Ala. 1989), *cert. denied*, 496 U.S. 912 (1990) ("*Reynolds*"). This places *amici* at a competitive disadvantage to corporations engaged in business in Alabama that are organized under the laws of Alabama (referred to herein as "domestic corporations").

Furthermore, it is apparent that Alabama believes that any attempt by *amici* to seek judicial review of the tax also would be barred by *res judicata* as a result of *Reynolds*. Thus, *amici* have an interest in both issues in this case.

1. Pursuant to S. Ct. R. 37.6, *amici* state that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amici*, has made a monetary contribution to the preparation or submission of this brief.

SUMMARY OF ARGUMENT

Alabama continues to rely on *Reynolds* to avoid judicial review of its discriminatory taxing scheme despite the direct conflict with due process and Commerce Clause[2] decisions of this Court.

Alabama's "extreme application" of *res judicata* directly conflicts with *Richards v. Jefferson County*, 517 U.S. 793 (1996) ("*Richards*"), by depriving petitioners, who were strangers to *Reynolds*, of due process. Alabama has, in effect, retroactively established an involuntary type of class action. In addition, petitioners are deprived of the ability to rely not only on subsequent Commerce Clause decisions of this Court but also on further factual development, a harsher result than applies to the parties themselves in an earlier tax case. This is unprecedented and plainly violates petitioners' (and *amici's)* due process rights.

The unconstitutionality of Alabama's discriminatory taxation of foreign corporations has been confirmed by subsequent decisions of this Court, which have repudiated the constitutional analysis in *Reynolds*. Consequently, it is important for this Court to bring Alabama's reliance on *Reynolds* to an end.

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2. U.S. Const. art. I, § 8, cl. 3.

ARGUMENT

I.

IN ADDITION TO BEING IN DIRECT CONFLICT WITH *RICHARDS*, ALABAMA'S "EXTREME APPLICATION" OF *RES JUDICATA* IS PARTICULARLY VIOLATIVE OF DUE PROCESS BECAUSE IT WOULD PERMANENTLY BAR STRANGERS TO THE *REYNOLDS* LITIGATION FROM BEING ABLE TO RELY ON SUBSEQUENT DECISIONS OF THIS COURT.

As petitioners demonstrate, Alabama's "extreme application" of *res judicata* directly conflicts with this Court's decision in *Richards*, another case from Alabama. As in *Richards*, the application of *res judicata* to petitioners, who were strangers to *Reynolds*, "deprive[d] them of the due process of law guaranteed by the Fourteenth Amendment." *Richards*, 517 U.S at 797. A party's due process right to obtain its own judicial review of a disputed issue is fundamental and stems from a "deep-rooted historic tradition that everyone should have his own day in court." *Martin v. Wilkes*, 490 U.S. 755, 762 (1989) (citing 18 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* § 4449, 447 (1981)). There is no meaningful distinction between this case and *Richards*.

Alabama apparently contends that *res judicata* is applicable here because petitioners and the taxpayers in *Reynolds* "can be said to be members of the same class." Respondents' Brief in Opposition ("Br. in Opp.") at 7. According to Alabama, this means that petitioners (and, presumably, *amici)* were "adequately represented by the taxpayers in *Reynolds*." Br. in Opp. at 7.

Alabama's application of *res judicata* to create a completely new and unprecedented involuntary type of class

action, without any of the usual class action protections for absent parties,[3] is directly foreclosed by *Richards*. Like the taxpayers in the case prior to *Richards*, the taxpayers in *Reynolds* --

> did not sue on behalf of a class; their pleadings did not purport to assert any claim against or on behalf of any nonparties; and the judgment they received did not purport to bind [any non-parties].

Richards, 517 U.S. at 801.

Alabama argues that the *Reynolds* taxpayers "adequately represented" petitioners because the *Reynolds* taxpayers "had every reason to protect [their own] interest." Br. in Opp. at 7 (emphasis added). Further, Alabama argues the *Reynolds* taxpayers --

> possess the resources to vigorously pursue their own best legal interests, and they did so. They were

3. *See, e.g.*, Fed. Rule of Civ. Proc. 23; Ala. Rule Civ. Proc. 23. *See also Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 811 (1985) ("*Phillips*"), a class action case, where this Court stated:

> [The absent plaintiff must receive] minimal procedural due process protection. The plaintiff must receive notice plus an opportunity to be heard and participate in the litigation. . . . Additionally, we hold that due process requires at a minimum that an absent plaintiff be provided with an opportunity to remove himself from the class by executing and returning an "opt out" or "request for exclusion" form to the court. Finally, the Due Process Clause of course requires that the named plaintiff at all times adequately represent the interests of the absent class members.

> represented in the prior litigation by some of the top law firms in the State of Alabama, which rendered to them more than competent representation.

Br. in Opp. at 8 (emphasis added).

The issue here, however, is not whether the *Reynolds* taxpayers were adequately represented by counsel or whether they vigorously pursued their own best legal interests. The issue here is whether parties who were strangers to the *Reynolds* litigation were adequately represented in the *Reynolds* proceeding. As this Court confirmed in *Richards*, adequate representation of absent parties would require that the *Reynolds* proceeding --

> at least . . . be "so devised and applied as to insure that those present are of the same class as those absent and that the litigation is so conducted as to insure the full and fair consideration of the common issue."

Richards, 517 U.S. at 801, (citing *Hansberry v. Lee*, 311 U.S. 32, 43 (1940)). It is far too late now for Alabama to attempt to establish retroactively that the petitioners in this case and the *Reynolds* taxpayers "are of the same class" and that *Reynolds* could have the preclusive effect of a class action.[4]

Here, as in *Richards*, "there is no reason to suppose that the [court in the prior decision] took care to protect the interests of the petitioners" or that the taxpayers in the prior suit "understood their suit to be on behalf of absent . . . taxpayers." *Richards*, 517 U.S. at 802. The court in *Reynolds* did not purport

4. Under Alabama's view of class actions, the affected class would expand indefinitely to include foreign corporations engaging in business in Alabama for the first time long after *Reynolds* was decided.

to form a class, and petitioners (and a*mici)* had no notice that they could be bound by that case, no opportunity to be heard or to opt out, and no connection whatsoever with the taxpayers in *Reynolds*. There is no justification for depriving petitioners (and *amici)* of the standard due process that is routinely accorded absent plaintiffs in a formal class action proceeding monitored by a court to ensure "adequacy of representation, the jurisdiction possessed over the class, and any other matter that will bear upon proper representation of the absent plaintiffs' interest." *Phillips*, 472 U.S. at 809.

The "extreme application" of *res judicata* in this case also has the effect of preventing taxpayers who were strangers to *Reynolds* from being able to rely on subsequent Commerce Clause precedent of this Court, including cases that are directly contrary to *Reynolds*. It is hard to imagine a more "extreme application" of *res judicata* given the general recognition that the parties themselves in an earlier case are not prevented from relying on such subsequent decisions of this Court when subsequent tax years are litigated. *See Limbach v. Hooven & Allison Co.*, 446 U.S. 353 (1984) ("*Hooven II*"); *Commissioner v. Sunnen*, 333 U.S. 591 (1948) ("*Sunnen*"); *see also State v. Plantation Pipeline Co.*, 265 Ala. 69, *cert. denied,* 352 U.S. 943 (1956).

In *Sunnen*, this Court rejected the attempt by the Commissioner of Internal Revenue to invoke collateral estoppel in a subsequent tax year, noting that collateral estoppel --

> is designed to prevent repetitious lawsuits over matters which have once been decided and which have remained substantially static, factually and legally. It is not meant to create vested rights in decisions that have become obsolete or erroneous with time, thereby causing inequities among taxpayers.

Sunnen, 333 U.S. at 599 (emphasis added).[5] Alabama should not be able to create a vested right in a decision that has become obsolete or was erroneous. It is interesting to note that, in *Sunnen*, there was no suggestion that the more preclusive doctrine of *res judicata* was potentially available.

The result in *Hooven II* is particularly illuminating. In *Hooven II*, the taxpayer argued that the Ohio Tax Commissioner was barred by collateral estoppel because of the prior holding in *Hooven & Allison Co. v. Evatt*, 324 U.S. 652 (1945) ("*Hooven I*"), which held that the "original package" doctrine of the Import-Export Clause of the United States Constitution prevented the State from taxing certain imported goods. However, the original package doctrine was subsequently

5. In the present case, intervening developments of both the law and significant facts have occurred. As discussed below, the legal basis upon which *Reynolds* was decided was unequivocally rejected by this Court in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) ("*Fulton*"); *Oregon Waste Sys. v. Department of Envtl. Quality*, 511 U.S. 93 (1994) ("*Oregon Waste*"); and *Associated Indus. v. Lohman*, 511 U.S. 641 (1994) ("*Associated Industries*"). Further, the Alabama Supreme Court based the decision in *Reynolds* in part upon an asserted lack of proof that the franchise tax in fact discriminates against foreign corporations. *Reynolds*, 558 So. 2d at 384-388. The trial court in this case found no such evidentiary gaps.

> The Court finds that the Taxpayer's evidence in this action clearly and abundantly demonstrates that the franchise tax on foreign corporations discriminates against them for no other reason than the state of their incorporation.

Pet. App. at 21a-22a (footnote omitted). ("Pet. App." references are to the appendices to the Petition for a Writ of *Certiorari* to the Supreme Court of Alabama in this case). Since intervening developments in both the law and the facts have occurred, collateral estoppel would be inapplicable even if the parties were the same.

invalidated in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), although the Court never specifically overruled *Hooven I*. The Ohio Supreme Court agreed with the taxpayer's argument that, notwithstanding the intervening decision of this Court, the Commissioner was collaterally estopped from re-litigating the validity of the original package doctrine in *Hooven II* because *Hooven I* dealt with the same issues and the same taxpayer. In reversing, this Court held that:

> [t]he years involved in this tax case, however, are not the same tax years at issue in *Hooven I*. Because of this, *Commissioner v. Sunnen*, *supra*, is pertinent and, indeed, is controlling . . . .

Hooven II, 466 U.S. at 362. This Court held that collateral estoppel could not override this Court's intervening pronouncement, noting that the reason for limiting the scope of collateral estoppel is especially strong when important constitutional issues are involved and the "constitutional analysis of the earlier case is repudiated by this Court's intervening pronouncement." *Id.*[6]

In this case, Alabama's application of *res judicata* enables Alabama to avoid compliance with the unmistakable effect of this Court's decisions in *Fulton, Oregon Waste,* and *Associated Industries* (which have repudiated the constitutional analysis of *Reynolds*). Thus, in addition to being in direct conflict with *Richards*, the "extreme application" of *res judicata* also is

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6. It is interesting to note that Alabama's theory would result in a different interpretation of the United States Constitution in Alabama. Commerce Clause precedent would continue to evolve in other States while frozen in time in Alabama. This result, in and of itself, could violate the Commerce Clause as it could lead to barriers to competition and economic Balkanization, consequences that the Commerce Clause was intended to prevent. *Oregon Waste*, 511 U.S. at 98-99.

contrary to *Sunnen*, and is plainly a denial of due process. How can a stranger to an earlier decision be more bound by that decision than the parties to that decision would be? *Amici* urge the Court make it plain to the States that resorting to spurious procedural obstacles in order to avoid this Court's precedent will not be countenanced.

II.

ALABAMA'S TAX PLAINLY VIOLATES THE COMMERCE CLAUSE, AND ALABAMA INAPPROPRIATELY RELIES ON *REYNOLDS* TO AVOID COMPLIANCE WITH THIS COURT'S DECISIONS IN *FULTON, OREGON WASTE*, AND *ASSOCIATED INDUSTRIES*.

Alabama's franchise tax on foreign corporations, Ala. Code § 40-14-41 (1993), discriminates against foreign corporations in direct violation of this Court's Commerce Clause precedent. As the trial judge found --

> the Taxpayer's evidence in this action clearly and abundantly demonstrates that the franchise tax on foreign corporations discriminates against them for no other reason than the state of their incorporation.

Pet. App. at 21a-22a (footnote omitted). This Court has consistently invalidated such discriminatory taxes. *See Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997); *Fulton; Associated Industries;* and *Oregon Waste*.

Alabama's defense of its discriminatory treatment of foreign corporations against Commerce Clause challenge is its reliance on the compensatory or complementary tax doctrine as applied in *Reynolds*. In setting forth its complementary tax argument in its brief in this case to the Alabama Supreme Court,

the State made no fewer than 18 references to *Reynolds*. State Department of Revenue's Brief to Ala. Sup. Ct. ("DOR Brief"), at 23–34 (May 25, 1997). *See also* Br. in Opp. at 10-17, where there are fifteen references to *Reynolds*.

But the subsequent opinions of this Court in *Fulton, Oregon Waste*, and *Associated Industries*, which more fully delineated the three requirements for application of the compensatory or complimentary tax doctrine, directly repudiate the Alabama Supreme Court's analysis in *Reynolds*. For example, in *Reynolds*, the Alabama Supreme Court stated:

> The question, as we see it, is whether the franchise tax on foreign corporations *invidiously* discriminates against them by imposing a grossly disproportionate tax on them for no other reason than to provide a competitive advantage to domestic corporations. We emphasize the term "invidiously" because the tax will be sustained if its classifications are rationally related to a legitimate state purpose and because, in enacting taxing statutes, legislatures are not required to reach equality with mathematical precision.

558 So. 2d at 382. But, in *Associated Industries*, this Court rejected as irrelevant the State's motive in enacting a tax, stating:

> [A] court need not inquire into the purpose or motivation behind a law to determine that, in actuality, the law impermissibly discriminates against interstate commerce.

511 U.S. at 653. This Court also confirmed in *Associated Industries*, that there is a "strict rule of equality" in applying the complementary tax doctrine. The State must show that its

tax on interstate commerce does not exceed its tax on intrastate commerce. *Associated Industries*, 511 U.S. at 646.

In this regard, petitioners have conclusively demonstrated that the franchise taxes on domestic and foreign corporations are not equal in view of the ability of domestic corporations to reduce their tax liability by reducing the par value of their stock. Alabama does not dispute the fact that domestic corporations can reduce their tax liability, arguing instead that --

> foreign corporations can reduce their tax liability by reducing the capital they employ in Alabama, just as domestic corporations can reduce their tax liability by reducing the value of their shares of stock.

Br. in Opp. at 12. It is amazing that Alabama would make such an argument since it reveals, as plainly as possible, the discriminatory effect of Alabama's disparate taxing system: domestic corporations can reduce their taxes by reducing the par value of their stock, but foreign corporations can reduce their taxes only by reducing the capital they employ in Alabama — that is, by moving or selling business operations located in Alabama. The two are hardly comparable. Such economic protectionism is a direct affront to the Commerce Clause and the precedent of this Court.[7]

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7. This Court has repeatedly recognized the necessity of treating the Nation as one economic unit:

> [I]n order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.

Oregon Waste, 511 U.S. at 98 (citing *Hughes v. Oklahoma*, 441 U.S. 322, 325-326 (1979)); *see generally* The Federalist No. 42 (James Madison). "[O]ur economic unit is the Nation, which alone has the gamut

(Cont'd)

A similar argument was rejected in *Kraft General Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, 505 U.S. 71 (1992) ("*Kraft*"), where this Court said:

> We have previously found that the Commerce Clause is not violated when the differential tax treatment of two categories of companies "results solely from differences between the nature of their businesses, not from the location of their activities." We find no authority for the different proposition advanced here that a tax that does discriminate against foreign commerce may be upheld if a taxpayer could avoid that discrimination by changing the domicile of the corporations through which it conducts its business.

Kraft, 505 U.S. at 78 (citation omitted). It is unthinkable that a discriminatory tax could be upheld simply because a taxpayer could diminish the tax by moving or selling operations located in the State, a much more significant consequence than changing the domicile of a corporation. Furthermore, Alabama's argument is wrong in any event. Even if a foreign corporation reduced its capital employed in Alabama by moving operations out of the State, discrimination would not be "avoided." The tax would still discriminate with respect to the corporation's remaining capital employed in Alabama.

The Alabama Supreme Court in *Reynolds* also failed to analyze, as required by this Court's decisions, whether the taxes in issue (the domestic franchise tax and the domestic shares

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(Cont'd)
of powers necessary to control the economy, . . . [and] has as its corollary that the states are not separable economic units." *Oregon Waste*, 511 U.S. at 98-99 (citing *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525 (1949)).

tax paid by domestic corporations and the foreign franchise tax paid by foreign corporations) were imposed on "substantially equivalent" events so that they served "as mutually exclusive prox[ies] for each other." *Oregon Waste*, 511 U.S. at 103; *Fulton*, 516 U.S. at 340 n.6. The domestic shares tax, an *ad valorem* personal property tax imposed upon Alabama residents on the value of stock holdings, and the franchise tax on foreign corporations, which is imposed on capital employed in the State, are not imposed on substantially equivalent events. Ala. Code § 40-14-70 (1985 Supp.) and Ala. Code § 40-14-41.[8] If Alabama wants to tax corporations on the amount of their capital employed in Alabama, it can and should impose such a tax on a nondiscriminatory basis on both domestic and foreign corporations. Until it does so, a separate decision to tax domestic corporations' capital stock cannot serve as a basis for taxing only foreign corporations on their capital employed in Alabama.

Alabama argues that this Court's post-*Reynolds* decisions "do not constitute a significant (if any) departure from the standards in effect at the time" *Reynolds* was decided. DOR Brief at 32; *see also* Br. in Opp. at 14. That argument, if correct, merely confirms that *Reynolds* was wrong when it was decided. In any event, the point is that this Court has set forth unequivocal standards for applying the complimentary tax doctrine to discriminatory taxes. *Reynolds* is in direct conflict with those standards and Alabama's continuing reliance on *Reynolds* should not be tolerated.

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8. It also is questionable whether the franchise tax on domestic corporations based on par value of their stock (Ala. Code § 40-14-40) (1993), and the franchise tax on foreign corporations are imposed on "substantially equivalent events."

CONCLUSION

The judgment of the Alabama Supreme Court should be reversed and the case remanded for further proceedings.

Respectfully submitted,

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November 9, 1998